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Agenda Item 6d

May 16, 2011

TO: MEMBERS OF THE INVESTMENT COMMITTEE

I. SUBJECT: AB 1379 (Bradford) – As Amended 3/14/2011
Reports on California and Emerging Domestic Market Investments

II. PROGRAM: Legislation

III. RECOMMENDATION: Neutral

IV. ANALYSIS:

Summary

The Legislature finds and declares that public pension fund investments represent billions of dollars of financing for California communities and that the State could adopt and implement more effective economic development policies with better information on fund investments in California and in emerging domestic markets.

Recognizing the significant reporting the California Public Employees' Retirement System (CalPERS) already does in this area, this bill would encourage, but not mandate, that each State and local pension system with assets over $4 billion to annually report to the Controller asset category, fair market value, and percentage of portfolio for all investments in California and in emerging domestic markets within the State. The report may also include an estimate of the number of jobs created and retained as a result of the System's investment activity.

Background

CalPERS Economically Targeted Investment Program

Approved by CalPERS Board of Administration (Board) in 2000, the Economically Targeted Investment (ETI) Program assists in the improvement of the economic well-being of California, its localities and residents by stimulating job creation; business creation; increases or improvement in affordable housing; and improvement of the infrastructure. CalPERS' strategic objectives are providing competitive risk adjusted rates of return while promoting growth and development of national and regional economies.

CalPERS California Emerging Markets Investment Policy

The California Emerging Markets Investment Policy is a component of the ETI. The Policy focuses on investment opportunities in traditionally underserved markets, including urban and rural areas undergoing or in need of revitalization. In 2001, the Board set a goal of investing two percent of the System’s assets in the emerging markets of the State. California Emerging Market Investments are included with similar investments in asset classes including fixed income, private equity, and real estate. Staff monitors and annually reports investment performance to the Board.

The decision to invest in underserved markets and consideration of its broader benefits only occur after the investment is deemed acceptable to the fund exclusively on its own economic investment merits. California Emerging Market Investments receive prudent level of due diligence, conducted by staff, designated external advisors or consultants, and consistent with the Board's ETI Policy. California Emerging Market Investments, whether in a stand-alone portfolio or incorporated with like investments which have no emerging market targeted orientation, are priced at least at market prices and are subject to applicable performance measurements.

The California Initiative

In 2001, the Board established the California Initiative within the Alternative Investment Management (AIM) program to invest private equity in traditionally underserved markets, primarily, but not exclusively in California.

Phase I of the California Initiative was launched in 2001 with a capital commitment of $475 million to nine private equity funds and one fund-of-funds. In October 2006, CalPERS made a second allocation of $500 million and established the Golden State Investment Fund (GSIF), which seeks to invest in both partnerships and direct co-investments primarily in California.

The primary objective of the California Initiative, comprised of both Phase I and GSIF, is to generate attractive financial returns, meeting or exceeding private equity benchmarks. As an ancillary benefit, the California Initiative has created jobs and promoted economic opportunity in California.

Since the inception of the California Initiative, 399 companies have received investment through both Phase I (284 companies) and GSIF (115 companies). Of the 284 companies in Phase I, (162 companies) have received funding through a $100 million separate fund-of-funds account allocated to the Banc of America California Community Venture Fund.

<u>CalPERS for California 2010</u>

The California Initiative has been an annual CalPERS report since 2005, and information on California specific investments has been reported since last year. This year, these two facets have been combined into the recently released annual report, *CalPERS for California 2010*, which highlights some of the broad ancillary benefits of CalPERS investments in California, together with the targeted impacts of the California Initiative. These benefits include jobs, business expansion, and infrastructure.

In turn, investment in California provides CalPERS with appropriate risk adjusted returns on investment. The decision by CalPERS and the third party investment managers with which it works to invest locally reflects the competitiveness of the financial returns available from companies, properties and projects located in California.

As of June 30, 2010, CalPERS invested:

- $6.1 billion in 644 California headquartered public companies, which employ over 700,000 people in the State, nearly five percent of the total workforce.
- $4.7 billion of fixed income capital in California, $810 million of which is invested in 14 California headquartered corporate bond issuers employing over 85,000 workers in the State.
- $2.9 billion in 1,331 California headquartered private companies, which support more than 140,000 local jobs.
- $3.3 billion in 387 California based real estate projects.
- $80 million of infrastructure capital is invested in six California based infrastructure projects with $73.6 million in projects providing reliable water supplies to drought prone areas.

<u>The California Pension Protection Act: Proposition 162</u>

The California Constitution Article XVI, Section 17 (as amended by the voters in 1992 as Proposition 162) provides the governing boards of public pension funds sole and exclusive authority over investment decisions and administration, and requires the boards to administer their systems so as to assure prompt delivery of benefits to participants and beneficiaries. The Section directs State and local pension systems to diversify their investments so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so. Last, it specifies that the delivery of benefits to participants and beneficiaries and the board's duty to participants and beneficiaries takes precedence over any other duty. The Legislature may, by statute, prohibit certain investments by a retirement board where it is in the public interest to do so, and provided that the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board.

<u>Public Retirement System Annual Report</u>

Existing law directs the California State Controller to annually compile and report to the public the financial condition of California's retirement systems. All state and local public retirement systems are required to submit audited financial statements to the State Controller within six months of the close of each fiscal year. Data from these individual reports are compiled and analyzed with the results published in the *Public Retirement Systems Annual Report*.

<u>Proposed Changes</u>

Specifically, this bill:

- Authorizes State or local public retirement systems with assets of over four billion dollars ($4,000,000,000) to include a report on California investments and emerging domestic market investments, as defined, in the mandated annual audited financial statements to the Controller.

    - Investments by asset class shall be reported by fair market value and percentage of the total portfolio. The report may also include an estimate of the number of jobs created and retained as a result of the system's investment activity.

    - Systems may report on total portfolios, rather than only those investments made after July 1, 2012, if information is provided and identified consistently with the definitions in in the bill.

- States Legislative intent that, consistent with their plenary authority and fiduciary responsibilities under Section 17 of Article XVI of the California Constitution, retirement systems with sufficiently diversified portfolios adopt emerging domestic market investment policies that meet their own unique investment objectives.

- Defines "California investment" as an investment that produces competitive risk-adjusted rates of return while still promoting economic and community development opportunities. This includes, but is not limited to:

- A publicly held company with a headquarters or significant operations in California.

- A privately held company that is headquartered in California.

- Real estate in California or loans on real estate located in California.

- Defines "emerging domestic market investment" as an investment that produces competitive risk adjusted rates of return while still promoting economic and community development opportunities to areas of the State that historically have had limited access to capital markets. "Emerging domestic market investment" also means an investment that produces competitive risk adjusted rates of return while still promoting economic and community development opportunities and that targets groups of people who are historically underserved.

- Requires the Controller to develop streamlined and cost effective methods for identifying investments that meet the definitions of California investment and emerging domestic market investment. The identification methods shall be prepared by June 1, 2012, updated at least every five years, and made available through the Controller's Internet website.

Legislative History

2006 AB 2570 (Arambula) – Required the Business, Transportation, and Housing Agency to develop a strategy to attract new private investment to the State and required public pension funds with assets over $4 billion to report annually on the value of their investments in California and historically underserved areas of the State. This bill was vetoed by the Governor, who stated his belief that the bill would impose new administrative costs on city and county pension systems. *CalPERS Position: Neutral.*

Issues

1. Arguments in Support

According to the author, California communities represent a potentially significant investment opportunity for institutional investors generating appropriate risk adjusted returns. The State, however, does not track investments made by public pension funds and does not engage private investors on how to make the State a more attractive place in which to invest. More private investment, in turn, could result in increased financial opportunities for the State's historically underserved capital markets, also known as emerging domestic markets (EDMs). AB 1379 mitigates these limitations by directly engaging private investors and beginning to track the large, fully diversified, public pension funds.

Support: California Reinvestment Coalition; California Small Business Development Centers; Latino Business Chamber of Greater Los Angeles; Small Business California; Small Business Finance; Small Business Financial Development Corporation of Orange County

2. Arguments in Opposition

   There is currently no known opposition at this time.

3. CalPERS Current Reporting and Definitions are Consistent with AB 1379

   Generally, CalPERS existing report would comply with the proposed requirements of AB 1379. As the *CalPERS for California 2010* report illustrates, the System operates investment programs that enrich the California economy, support emerging domestic markets, and provide CalPERS with appropriate risk adjusted returns on investment.

   Investments are reported by asset class, by fair market value and percentage of the total portfolio. The *CalPERS for California 2010* report identifies the amounts invested in specific regions of California, and the percentage of the total portfolio invested. It also includes an estimate of the number of jobs created and retained as a result of the system's investment activity.

   The definitions of "California investments" and "emerging domestic markets" contained in AB 1379 are also currently consistent with those currently used by CalPERS.

4. Legislative Policy Standards

   The Board's Legislative Policy Standards suggest a neutral position on proposals which do not significantly affect the benefit interests of our stakeholders and which do not significantly impact CalPERS benefits or the administration of the system. AB 1379 would allow CalPERS to include in the annual audited financial statements submitted to the State Controller information on investments in California and all assets in emerging domestic markets within the State, obtained on or after January 1, 2012, but would not significantly impact CalPERS benefits or the administration of the System.

V. STRATEGIC PLAN:

This item is not a product of the CalPERS strategic plan, but an ongoing responsibility of the CalPERS Office of Governmental Affairs.

VI. RESULTS/COSTS:

AB 1379 allows, but does not require, CalPERS to submit a report to the Controller on California and emerging domestic market investments as specified. In the event that CalPERS decides to submit the requested information it could meet the requirements of the law by submitting the information contained in the annual report it currently produces on investments in California.

Program Costs

There are no known new program costs at this time. CalPERS already supports a policy of investment in emerging domestic markets within the State. Additional programmatic costs may apply if the definition of California Investments or emerging domestic markets differs widely from CalPERS definitions.

Administrative Cost

Administrative costs will be minimal, requiring slight modification to reports already submitted to the Controller. Additional administrative costs may apply if the definition of California or emerging domestic market investments differs widely from CalPERS definitions.

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